SUPREME COURT, U. S.

No. 1178

FILED

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E. ROBERT SEAVER, CLERK

Supreme Court of the United States

OCTOBER TERM 1970

SECURITY MUTUAL CASUALTY COMPANY
Petitioner,

VERSUS

THE FIRST NATIONAL BANK OF CUSHING, CUSHING, OKLAHOMA, a National Banking Association; ROBERT W. ADAMS; ROBERT W. ADAMS, Executor of the Will of Alice M. Steele; FRANK C. BERRY AND GEORGE M. BERRY, Executors of the Will of James E. Berry, deceased; LEVI SWINGLE; ARTHUR BLAINE BELL; E. L. ROBERTS; D. A. GRIFFIN; AND GEORGE M. BERRY
Respondents

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

CARL PRESSTON
JAMES C. PRESSTON
R. H. WILLS, SR.
620 Nat. Bk. of Comm. Bldg.
Tulsa, Oklahoma 74103
Attorneys for Petitioner

WAYNE R. SCOTT CO., (918) 587-6582, 527 S. CUSTER, TULSA, OK. 74120

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THE FIRST NATIONAL BANK OF CUSHING, CUSHING, OKLAHOMA, a National Banking Association; ROBERT W. ADAMS; ROBERT W. ADAMS, Executor of the Will of Alice M. Smith; FRANK C. BERRY AND GEORGE M. BERRY, Executors of the Will of Jason E. Berry, deceased; LEVI STERRETT; ARTHUR BLAINE HILL; E. L. ROBERTS; D. A. GRIFFIN; AND GEORGE M. BERRY
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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

TO THE HONORABLE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Security Mutual Casualty Company, the petitioner herein, prays that a writ of Certiorari issue to review the

judgment of the United States Court of Appeals for the Tenth Circuit entered in the above entitled cause on August 20, 1970.

A. OPINIONS BELOW

The opinion of the Court of Appeals for the Tenth Circuit has been reported in 431 F. 2d 1085 and is printed in Appendix A hereto at Page A-1. The Findings of Fact, Conclusions of Law and Judgment of the United States District Court for the Western District of Oklahoma as amended are printed in Appendix B hereto at Page A-12.

B. JURISDICTION

The Judgment of the Court of Appeals was entered on August 20, 1970. Petitioner's Petition for Rehearing was denied on November 5, 1970. The jurisdiction of the Court is invoked under 28 U.S.C. Sec. 1254(1). An Order Staying Mandate was issued on _____, 1970, granting a stay of thirty days pursuant to Rule 41(b) Federal Rules of Appellate Procedure.

C. QUESTIONS PRESENTED FOR REVIEW

1. When a bank president willfully makes an excess loan in violation of 12 U.S.C. Sec. 84, either by holding the customer's insufficient funds checks or making loans to the customer, or a combination of both, is that

a willful misapplication of bank funds in violation of 18 U.S.C. Sec. 656?

2. When a bank president makes one excess loan by lending the bank's limit to each of two customers at the same time secured by the same collateral and the bank directors approve that loan and remove one-half of it from the bank by purchasing the note of one customer, do they remain personally liable for the balance of the excess loan, i.e. the note of the other customer?

3. When bank directors are notified on several occasions that the president had engaged in improper practices and had made excess loans, may the directors each time rely on his explanation or must the directors make independent investigation and terminate the practices, his employment, or both?

4. When a bank learns through its directors on three different occasions that its president has made excess loans may the bank withhold that information from its surety and thereafter collect from the surety for subsequent losses caused by the bank president on those same accounts?

B. STATUTES INVOLVED

Since the statutes involved are lengthy, only their citations and pertinent text is herewith set forth.

12 U.S.C. Sec. 84. The total obligation to any na-

tional banking association of any person, co-partnership, association or corporation shall at no time exceed 10 percentum of the amount of the capital stock of such association actually paid in and unimpaired and 10 percentum of its unimpaired surplus fund. . . .

12 U.S.C. Sec. 93. If the directors of any national banking association shall knowingly violate or knowingly permit any of the officers, agents or servants of the association to violate any of the provisions of this chapter, all the rights, privileges and franchises of the association shall be thereby forfeited. . . . And in such cases of such violation every director who participated in or assented to the same shall be held liable in his personal and individual capacity for all damages which the association, its shareholders or any other person shall have sustained in consequence of such violation.

18 U.S.C. Sec. 656. Whoever, being an officer, director, agent or employee of or connected in any capacity with any Federal Reserve Bank, member bank, national bank or insured bank . . . embezzles, abstracts, purloins or willfully misapplies any of the moneys, funds or credits of such bank or any moneys, funds, assets or securities entrusted to the custody or care of such bank, or to the custody or care of any such agent, officer, director, employee or receiver, shall be fined not more than $5,000.00 or imprisoned not more than five years, or both; . . .

E. STATEMENT OF THE CASE

Suit was brought by a national bank against its surety alleging losses caused by fraudulent and criminal acts of the bank's president, Swingle. Jurisdiction was based upon diversity of citizenship and amount involved. The surety denied liability on the basis that the bank had notice of these and preceding wrongful acts and failed to notify surety of them. In a third party complaint against the directors, the surety also alleged that the directors were liable to surety for assenting to excess loans. The case was tried without a jury and the Court awarded the bank a judgment for $500,814.47 against the surety. Surety was denied relief on its third party complaint except against the wrongdoer and his colleague.

All parties agree that Swingle's acts were criminal, fraudulent, and caused losses. No one has questioned the rule of law involved: If the insured received notice of wrongdoing by its employee, it must give notice to the surety and obtain surety's consent to continuing the employment, or no later losses will be insured. Nor does anyone question that the bank received notice of certain illegal and improper acts. The Court of Appeals minimized the importance of the improper practices brought to the directors' attention and then based its decision on negligence of directors rather than upon the absolute duty to notify the surety of any wrongdoing by the insured employee.

Swingle committed two kinds of wrongful acts. He paid insufficient funds checks for customers without recording them and he made excess loans. Sometimes the payment of insufficient funds checks constituted an excess loan either alone or in conjunction with other loans to the same customer.

On several occasions the directors learned Swingle was paying customers' checks and holding them as bookkeepers' returns to avoid properly posting them as overdrafts on the customers' accounts and making illegal loans. The following quoted matter was reported to the directors in the bank examiners' reports under the heading "Examiner's Comments on Matters Requiring Attention."

On February 13, 1962, examiners reported checks totalling $8,121.64 which had been paid and held as long as twenty-five days without posting to the customers' accounts as of November 28, 1961. (A 43) They also reported an excess loan, saying *"Violations of Law.* The combination of loans scheduled on page 8 as being in excess of the bank's legal limit as prescribed by Section 5200 USRS should be reduced to conforming status."

On October 9, 1962, examiners reported two excess loans, one created by holding Reagin's checks improperly, and the habitual holding of checks as bookkeeper's returns to prevent overdrafts as of July 24, 1962, saying in part "Two excessive loans listed at Page 8-A were reduced to within the legal limit during the examination.

Directors are reminded that under the provisions of Section 5200 USRS, they may be liable for any loss sustained on account of excessive loans. Provisions of Section 5200 USRS should be strictly observed." (A 43-44)

On December 5, 1962, Swingle admitted he had made an excess loan to Small and Jones. (A 24)

On March 12, 1963, examiners reported checks held to prevent overdrafts as of February 13, 1963, including Reagin's checks, and demanded the directors curtail it, saying "The holding of bookkeepers' returns to prevent overdrafts should be curtailed. All cash items should be regularly listed and approved in Board minutes." (A 44)

On November 11, 1963, examiners reported excess loan to Reagin by improperly holding checks as of October 21, 1963, saying "Even though the excessive credit listed on page 8 was corrected during the examination, the Board is reminded of their individual responsibility on any excess or illegal loan."

The opinion of the Court of Appeals recites that directors did receive notice of excess loans and checks improperly held.

> "The examinations did disclose that item returned from the bookkeepers were held from time to time by the officers and this fact was criticized." (A 7)
>
> "... it was a practice criticized by the examiners as it was not considered proper banking practice." (A 7)

"...in each instance the returns which were criticized were cleared up." (A 7)

"...on one occasion the report showed the checks had been held for several weeks." (A 7-8)

"The record demonstrates that the excess loans were not the fraud or wrongdoing upon which the action was based, but instead a device used by Swingle to hid his prior wrongdoings, of which the directors were unaware. One excess loan was brought to the attention of the directors and its was explained as excess by Swingle because it was on the same security used by another customer. This loan was taken out of the bank by the directors purchase of it which was itself proper. The directors had no indication that the loan was otherwise improper as Swingle concealed its purpose and origin." (A 9)

The Court of Appeals held that these warnings did not amount to discovery of wrongdoing and affirmed the judgment of the Trial Court because: The directors relied upon the explanations of Swingle, who was active in church and public affairs and in whom they had confidence; the checks improperly held were cleared up during the examination or shortly afterwards; the directors never knew his device for holding checks; the excess loans were not the basis of the action; and these same improper practices existed in other banks.

In summary, the opinion recites that the directors received notice of improper practices and excess loans but were allowed to disregard this notice and obtain

reimbursement from the surety for the very losses they were warned against.

F. REASONS FOR ALLOWANCE OF WRIT

The economic system of this country depends upon the solvency of national banks. To guard against reckless lending and improper practices, restrictions of loans and bank examinations are provided. 12 U.S.C.A. 84, 161. But management of such banks is vested in the board of directors. 12 U.S.C.A. 71. Upon the board of directors rests the duty to control lending, terminate improper practices and, if necessary, to discharge trusted employees who disobey regulations.

The directors of this bank received four warnings of improper handling of checks and four warnings of excess loans. They left the wrongdoer in charge of the bank. The resulting losses from transactions with just two customers equalled the total capital of the bank. The directors impaired the solvency of this bank by failing to heed warnings about handling checks and excess loans. The directors should not be exonerated, to do so defeats the purpose of the safeguards. By reciting the warnings and exonerating the directors, the Court of Appeals has impaired these safeguards. The decision should be reversed.

This Court should hold that an excess loan willfully made is a willful misapplication of bank funds in violation

of 18 U.S.C.A. 656. Any loan is an application of bank funds; a loan in violation of 12 U.S.C.A. 84 is a misapplication of bank funds; and if it is willfully made it is a criminal misapplication of funds. This important question of Federal law has not been settled and should be settled.

The Court of Appeals has absolutely contradicted the holding in *Corsicana National Bank v. Johnson*, 251 U.S. 68, 87, 40 S.Ct. 82, 64 L.Ed. 141. When a bank makes simultaneous loans to two customers secured by the same collateral, the two loans are considered one loan under 12 U.S.C.A. 84. If the total exceeds the bank's limit, then the whole amount loaned is one excess loan. The directors are liable for the full amount, not just the excess portion. 12 U.S.C.A. 93.

The Small-Jones loans were made the same day on the same collateral. Swingle admitted to the directors the illegality of the loans. Three directors, including Swingle, purchased one-half of the loan represented by the Small note and approved the rest. The directors are liable to surety for the balance of the illegal loan, i.e. the Jones note, which is the first loss included in this judgment. These facts are set forth in the findings of fact and opinion. (A 9, 24). The failure to reverse this decision will impair the rule of *Corsicana National Bank v. Johnson*, supra.

When Swingle admitted the illegal Small and Jones

loan the directors discovered his fourth excess loan within the year. They had also received two warnings about improper holding of insufficient funds checks. The opinion recites these warnings and explains that the holding of checks improperly resulted in the losses in question. In reciting these warnings and affirming the judgment against the surety the Court of Appeals has contradicted decisions of this Court, of the Fourth Circuit, and of the State of Oklahoma. *Guarantee Company of North America v. Mechanics Savings Bank & Trust Co.*, 183 U.S. 402, 22 S.Ct. 124, 46 L.Ed. 253 (1902); *Pickleimer v. United States Fidelity & Guaranty Co.*, 54 F. 2d 1022 (4th Cir. 1932); *Phoenix Insurance Co. of Hartford v. Newell*, 60 Okl. 207, 159 P. 1127 (1916); *Great Southern Life Insurance Co. v. Long*, 93 Okl. 129, 219 P. 926 (1923); *Briggs v. J. R. Watkins Co.*, 195 Okl. 254, 157 P. 2d 482 (1945). See also *Couch on Insurance* 2d, Sec. 49:247, p. 268-269 and *Appleman on Insurance*, Vol. 10, Sec. 6216, p. 582.

When Swingle admitted the excess loans to Small and Jones, the directors discovered a violation of Federal statute and a criminal misapplication of bank funds. The bank could have collected its losses from the surety at that point. *Corsicana National Bank v. Johnson*, supra. Having withheld this knowledge from the surety, the bank cannot recover for its later losses caused by the same employee.

This opinion is antagonistic to two statutory provisions designed to protect the solvency of national banks. It minimizes the importance of bank examiners' warnings and excess loans. The Court has subordinated the warnings of bank examiners to the explanations of the criticized employee. (A 8) The Court also implies that the participation in and assent to excess loans is not material unless the bank chooses to base its action against the surety on this particular wrongdoing. (A 9)

The Court's justification for the directors' conduct conflicts with opinions of this Court and the courts of other circuits. The opinion states that the directors may rely on the explanation of the criticized employee contrary to *Guarantee Company of North America v. Mechanics Savings Bank & Trust Co.*, supra. The opinion states that in each instance the criticized items were cleared up later. An employee who reimburses the bank for his misapplications is still guilty. *U.S. v. Fortunato*, 402 F. 2d 79 (2nd Cir. 1968). The opinion states the directors did not know about "cycling" Swingle's "device" for holding checks, but other circuits have held that knowledge of the method is not necessary to know that a crime has been committed and to be guilty of aiding and abetting. *Benchwick v. U.S.*, 297 F. 2d 330 (9th Cir. 1961); *U.S. v. Marinelli*, 142 F. 2d 446 (3rd Cir. 1944); *U.S. v. Caplan*, 123 F. Supp. 862 (W.D. Pa. 1954).

This Court should accept jurisdiction to settle these Federal questions of vital importance to financial institutions and resolve conflicts created by the opinion of the Court of Appeals: (1) An excess loan willfully made is a criminal misapplication of bank funds; (2) when directors discover an excess loan and assent to it, they are liable for the full amount of it to anyone who suffers because of it; (3) when directors learn of improper practices they must investigate and terminate those practices or they will be liable for the resulting losses; and (4) when directors learn of excess loans or other improper practices they have an absolute duty to notify the surety or subsequent losses will not be insured.

CONCLUSION

For the foregoing reasons this Petition for a Writ Certiorari should be granted.

Respectfully submitted,

CARL PINKERTON
JAMES C. PINKERTON
R. H. WILLS, SR.
602 Nat. Bk. of Comm. Bldg.
Tulsa, Oklahoma 74103
Attorneys for Petitioner

APPENDIX A

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

No. 9469—JULY 1970 TERM

THE FIRST NATIONAL BANK OF CUSHING, CUSHING, OKLAHOMA, a national banking association, Appellee

v.

SECURITY MUTUAL CASUALTY COMPANY, Appellant

v.

ROBERT W. ADAMS; ROBERT W. ADAMS, EXECUTOR OF THE WILL OF ALMA M. BLANK, deceased; FRANK G. BERRY, and GEORGE M. BERRY, EXECUTORS OF THE WILL OF JAMES E. BERRY, deceased; LEVI SWINGLE; ARTHUR BLAINE IMEL; E. L. ROBERTS; D. A. GRIFFIN, and GEORGE M. BERRY Appellees

Appeal From The United States District Court For The Western District of Oklahoma (D. C. Civil No. 68-388)

This suit was commenced by the plaintiff, a national bank, against the defendant bonding company for recovery on a banker's blanket bond and on an excess fidelity policy issued by the defendant. This action was based upon a loss to the bank resulting from fraudulent

and criminal acts by an officer of the bank. The case was tried without a jury, and a judgment was rendered against the bonding company in the amount of $560,814.47. The bonding company has taken this appeal.

The bonding company filed a third-party complaint against some of the directors of the bank and also against the officer-director who was involved in the criminal acts and against an additional officer-director. The trial court dismissed the third-party complaint against all the directors except the two officer-directors.

The officer of the bank who was responsible for the losses was tried on a criminal charge and was convicted. In this action there is no question as to the criminal nature of his act, nor the amount of losses which resulted. See *Swingle v. United States*, 389 F. 2d 220 (10th Cir.).

From the record it appears that Mr. Swingle over a period of several years permitted the payment of overdrafts on a commercial account by withholding insufficient checks written by the customer from the bank records for extended periods of time, and by subsequent issuance of fictitious drafts, granting fictitious loans, and questionable purchases of equipment. Another officer, also a longtime employee of the bank, had knowledge of the methods used by Swingle to accomplish the payment of the checks and the withholding of them from the bank

records. Other losses occurred on another account where the bank's funds were advanced to a sole proprietorship after the death of the proprietor and to a bankrupt corporation owned by the same person through the use of fictitious notes. The fraudulent schemes of Swingle were not disclosed by the examination made by the bank directors nor were they disclosed by examination made of the bank by the national bank examiners over a period of several years. Swingle had been employed by the bank in various responsible positions for approximately thirty-five years, and at the time of the incidents in question was president of the bank and had the complete trust and confidence of the directors. He was also active in public and church affairs in the community of Cushing, Oklahoma.

The principal issue on this appeal is whether or not the directors had notice of the fraudulent acts of Swingle by reason of their examinations of the bank or by reason of the contents of the reports submitted to the board by the national bank examiners. The appellant bonding company asserts they had such notice long before notifying the bonding company and that the bank directors were negligent to an extent that it is relieved from liability on its bond. Also the company urges that the bank should be held to have knowledge of the wrongdoing by reason of the contents of its records.

The case thus comes to us basically as a substantial

evidence case. The trial court made findings of fact on the three issues referred to above. These findings must, of course, stand unless clearly erroneous. Of equal importance it is for the trial court to draw the inferences from the facts, and again if not clearly erroneous will stand although there be other possible inferences. *Butler Paper Co. v. Business Forms, Ltd.*, 424 F. 2d 247 (10th Cir.); *National Farmers Union Service Corp. v. United States*, 400 F. 2d 483 (10th Cir.), and *Rosenfield v. Kay Jewelry Stores, Inc.*, 384 F. 2d 98 (10th Cir.). It found that the directors had no knowledge of the wrongdoing by Swingle and were not put on notice thereof by reason of their examinations nor by reason of the reports made by the national bank examiners. The trial court found that the directors were not negligent in the performance of their duties and that they had no knowledge of the wrongdoing by reason of the bank's own records.

We conclude from an examination of the record that the findings of the trial court are fully supported by the evidence. The principal differences between the appellant and the appellee in this appeal are resolved by an analysis of just what the directors were notified or advised of by the reports made by the national bank examiners. In a consideration of this issue, which is a factual one, it is necessary to briefly consider how Swingle

used the bank's bookkeeping practices to effect the fraud and to conceal it.

The record shows that the bank used a deferred posting system whereby checks received by the bank on a particular day were accumulated and held to be posted by the bookkeeping section on the day following. The bank's records revealed only totals of the checks received and deposits made for any particular day. On the second day when the checks went to the bookkeeping department, the checks which were regular in all respects were posted to the individual accounts; however, checks which were post-dated, had improper signatures, or were on accounts which had insufficient funds to pay them, or were otherwise irregular, were not posted but were accumulated and returned by the bookkeeping department to an officer of the bank. The bookkeeping department returned these checks for the reason that the employees there had no authority to enter or to post overdrafts or other irregular checks. Instead some disposition of these checks had to be made by an officer of the bank. These checks which were so returned are referred to in this record as "bookkeeper's turnbacks," or "bookkeeper's returns." A check so turned back by the bookkeeping department on a particular account was given for disposition to the officer who ordinarily handled the particular customer's account. This officer would in the ordinary and proper practice see that the

check was corrected or would authorized its posting as an overdraft. The item would be entered as an overdraft or as a cash item on the books of the bank.

The record indicates that Swingle, as to two particular accounts which he handled, and particularly on the one account in which the largest loss took place, when he would receive an insufficient fund check on the account from the bookkeeping department as a turnback, he would that day or later put the check back through a teller's window and again it would proceed through the deferred posting system and would be again returned several days later to him as a bookkeeper's turnback. This repeated return and redeposit of the checks was referred to as a "cycling." The way in which it was used by Swingle with the result that checks were held by the bank for several days in turn caused the insufficient fund checks to be paid by the bank as they could not be returned to the bank or person sending them to the Cushing bank for payment. Further by reason of the cycling, the checks were withheld from proper recording in the books and records of the bank.

The record also shows that Swingle, when the accumulation of checks in his cycling became large or when some examination was imminent, would forward a fictitious draft for the customer to another bank, make a fictitious loan, or a questionable purchase of equipment

from the customer to provide sufficient funds in the account and to remove the checks from the cycle.

As indicated above, the repeated examinations of the bank made by the national bank examiners did not disclose the fraud of Swingle because it did not disclose the fact that he was cycling the checks. The examinations did disclose that items returned from the bookkeepers were held from time to time by the officers and this fact was criticized. It is apparent from the record that the temporary holding of items returned from the bookkeepers was a common practice in banks at the time in order that mistakes and errors in regard to the checks could be corrected, but that it was a practice criticized by the examiners as it was not considered proper banking practice.

The position of the bonding company appellant in this appeal is that the directors received notice of the fact that the officers were holding the bookkeeper's turnbacks, and this was sufficient to put them on notice of the fraudulent methods being used by Swingle. On the other hand, the appellee argues that the notice to be derived from the reports of the national bank examiners was no more than of a fairly common poor banking practice of temporarily holding the turnbacks. The record shows that in each instance the returns which were criticized were cleared up during the course of the examination or immediately thereafter. Although on one

occasion the report showed the checks had been held for several weeks, the reports of the national bank examiners were considered by the directors at their regular meetings, the officers were questioned about the items, and in each instance were told that the particular item had been properly cleared. The directors were entitled to rely upon such explanations.

The record thus demonstrates that the directors did not receive any notice of the fraudulant acts of Swingle prior to the ultimate disclosure of the cycling of checks made by Swingle. The reports of the bank examinations did not contain any information which could constitute notice of the dishonest acts. Thus the record shows only that the directors had notice of a practice which was not necessarily in accord with the best banking practices, but which was common and which was in each instance fully explained at the time. The fraud of Swingle was the cycling of the checks which was not disclosed until he advised the chairman of the bank that he was cycling checks drawn on a particular account and which then totaled a substantial sum. The chairman advised the national bank examiners of this fact and they immediately came to the bank and conducted an examination which disclosed the fraud. The examiners who had conducted examinations prior to this time and who submitted reports testified that they then had no knowledge of the fact that Swingle was cycling checks in a manner to ensure

their payment and to thereby defraud the bank, and consequently their comments in their reports to the directors did not refer to this device used by Swingle, but instead referred only to the holding of the bookkeeper's turnbacks which was a not uncommon practice.

The appellant also urges that the directors in some manner participated in the wrongdoing or were grossly negligent by reason of the granting of excess loans to certain customers whose accounts were used by Swingle in the manner described above. The record demonstrates that the excess loans were not the fraud or the wrongdoing upon which the action was based, but instead were a device used by Swingle to hide his prior wrongdoing of which the directors were unaware. One excess loan was brought to the attention of the directors, and it was explained as excess by Swingle because it was on the same security used by another customer. This loan was taken out of the bank by the directors' purchase of it, which was itself proper. The directors had no indication that the loan was otherwise improper as Swingle concealed its purpose and origin.

The record further demonstrates that the finding of fact by the trial court that the directors were not negligent is also supported by the evidence. The directors' examinations were made regularly and in accordance with good practice, and the fact that these examinations did not disclose the fraud did not constitute negligence

under the circumstances as demonstrated by the examiners' failure to find the fraud. See *Hughes v. Reed*, 46 F. 2d 435 (10th Cir.). Also Swingle and the other officers who had knowledge of Swingle's cycling of checks were the only regular employees or officers of the bank who were also directors, and they participated in and directed the examinations in a manner to prevent knowledge by the other directors of the devices used by Swingle.

The appellant also asserts that the directors should have had knowledge of the fraud by reason of the records of the bank itself, but there is no merit in this position in view of the nature of the action and the nature of the fraud concerned.

We also find the contention of the appellant that the acts of the bank released the bonding company to be without merit. This argument relates to the participation in the bankruptcy of one of the customers whose account is concerned. This participation relates to the attempt by the bank to recover on what security and assets of the customer were available and cannot constitute an act which would in any way release the bonding company.

We agree with the district court that the losses occurred, that the policies covered the losses, and that the directors were without prior notice. The judgment of the trial court as entered was proper, including the in-

terest as allowed. *Phoenix Ins. Co. v. Diffie*, 270 P. 2d 634 (Okla.).

AFFIRMED.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF OKLAHOMA

THE FIRST NATIONAL BANK OF CUSHING, CUSHING, OKLAHOMA,
a national banking association
Plaintiff

vs.

SECURITY MUTUAL CASUALTY COMPANY,
a corporation,
Defendant

No. 66-366, Civil.

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Findings Of Fact And Conclusions Of Law

The above-entitled action came on for trial before the Court without a jury, the plaintiff appearing by its attorneys, David M. Thornton and Gerald G. Stamper, the defendant and third-party plaintiff appearing by its attorneys, Carl Pinkerton, James C. Pinkerton and Richard H. Wills, Sr., the third-party defendant Robert W. Adams, individually and as Executor of the Estate of Alma M. Blank, Deceased, appearing in person and by his attorney Hess Crossland, the third-party defendant Arthur Blaine Imel appearing in person and by his at-

torney John M. Imel, the third-party defendant D. A. Griffin appearing in person and by his attorney, H. Dale Cook, the third party defendant George M. Berry, individually and as an Executor of the Will of James E. Berry, Deceased, appearing by his attorney, Lynn J. Bullis, Jr., and James W. Rodgers, Jr., the third-party defendant Frank G. Berry, as an Executor of the Will of James E. Berry, Deceased, appearing in person and by his attorneys, Lynn J. Bullis, Jr., and James W. Rodgers, Jr., the third-party defendant E. L. Roberts appearing in person and by his attorneys, Paul G. Darrough and Donald L. Worthington, and the third-party defendant Levi Swingle appearing in person and by his attorney, Jack B. Sellers, and testimony, evidence and arguments having been offered by all parties, and the Court having been duly informed and advised in the premises, now makes and files its

Findings Of Fact

1. Plaintiff, the First National Bank of Cushing, Cushing, Oklahoma, a national banking association with its place of business at Cushing, Oklahoma, instituted this action against defendant, Security Mutual Casualty Company, an Illinois corporation with its principal place of business at Chicago, Illinois, to recover, under a Bankers Blanket Bond and an Excess Fidelity Policy issued by defendant, losses sustained by reason of the dishonest, criminal and fraudulent acts and wrongful ab-

stractions and misapplications of plaintiff's funds by Levi Swingle, who was at the times of such wrongful acts employed by plaintiff as its president. The defendant denied all liability to plaintiff, contending that the directors of plaintiff during the period involved actually knew of the wrongful acts of Swingle alleged by plaintiff and approved and ratified them, or that the directors, by exercising reasonable care and diligence in the performance of their duties, would have known of such acts of Swingle and could have acted to prevent the losses sustained by plaintiff and could have given notice to defendant of Swingle's defalcations. Defendant, claiming to be entitled to subrogation to the rights of plaintiff, joined as third-party defendants Robert W. Adams, Alma M. Blank, James E. Berry, Arthur Blaine Imel, D. A. Griffin, George M. Berry, Levi Swingle and E. L. Roberts, each of whom had been a director of plaintiff during all or part of the period involved. Defendant, as third-party plaintiff, alleged that each of the third-party defendants had actual or constructive knowledge of Swingle's wrongful acts and asserted both statutory and common law liability. James E. Berry and Alma M. Blank died prior to the trial and their executors were duly substituted as third-party defendants. Levi Swingle denied that he was liable, denied any wrongdoing and asserted that all of his acts as president of plaintiff had been in accordance with the policies established by the board of directors. The remaining third-party defendants denied all liability, denied

knowledge of any wrongdoing by Swingle and alleged that, as directors of plaintiff, they had at all times acted in the utmost of good faith and had exercised due diligence and care in the supervision and management of the bank's affairs. The third-party defendants further alleged that the claims asserted against them were barred by the Statute of Limitations. The defendant counterclaimed against plaintiff for loss of any rights of subrogation barred by limitations because of plaintiff's failure to give notice to it of the wrongful acts being perpetrated by Swingle, all as set forth in the pleadings and pretrial order.

2. A Bankers *Blanker* Bond and an Excess Fidelity Policy issued by defendant to plaintiff were in full force and effect from August 9, 1962, and October 16, 1961, respectively, as to losses discovered after 7:00 a.m. on such dates. The bond and policy continued in force until August 6, 1965. By those instruments defendant undertook and agreed to pay and make good to plaintiff all losses sustained by plaintiff at any time but discovered after the effective dates by reason, inter alia, of the fraud, dishonesty, wrongful abstraction or misappropriation or any other dishonest, criminal or fraudulent act of any officer or employee of plaintiff; defendant's liability being limited to a maximum of $1,000,000.00 for any one loss. In addition, under the Bankers Blanket Bond the defendant agreed to pay and make good to plaintiff all losses sustained by plaintiff by reason of court costs, attorneys'

fees and legal expenses incurred in the investigation or defense of any demand, claim or suit brought against plaintiff, which, if paid by plaintiff, would result in a loss covered by the bond. The bond also provided that defendant would pay all necessary and reasonable expenses incurred and paid by plaintiff in preparing any valid claim for loss covered by the bond, not to exceed $1,000.00 in respect to any one such loss. (Plaintiff's Exhibit 1, 1A; R 39; Stipulation R 799; Admitted in the pleadings.)

3. Levi Swingle was an officer, director and full-time salaried employee of plaintiff from 1929 until November, 1964. (R 590, 598, 421) He served as president from a time prior to 1960 until termination of his employment. (R 596, 776) E. L. Roberts was vice-president and cashier, a director and a full-time salaried employee of plaintiff from July, 1949, until March, 1965. (R 776) Robert W. Adams, Alma M. Blank and Arthur Blaine Imel were directors of plaintiff from several years prior to 1960 until June, 1967. (R 323, 324, 332-335, 599, 690) D. A. Griffin has been a director of plaintiff from February, 1962, until the present. (R 451, 600, 681) James E. Berry was a director of plaintiff from 1929 until January, 1964. (R 675-6) George M. Berry was a director of plaintiff from January, 1964, until July, 1967. (R 676)

4. The plaintiff's principal claims are three in number based upon alleged wrongful, fraudulent and dis-

honest withdrawal of money from plaintiff's bank to customers possessing more than one bank account, otherwise, single customers with multiple names as follows:

1. G. E. Reagin, Reagin Trucking Company, Reagin Transportation Company, Reagin Oil Company, Warren Transportation Company (Warren Reagin, son of G. E. Reagin) hereinafter generally referred to as "Reagin."

2. H. J. Reaves, Reaves Oil Company, Reaves Oil Well Drilling Company, hereinafter referred to as "Reaves."

3. Jim Caton, Caton, Inc., Caton Dirt Movers-Bulldozing, Allied Businesses and names of Jim Caton's relatives hereinafter referred to as "Caton."

5. The plaintiff contends that growing out of the Groendyke Reagin contract it is entitled to judgment in the sum of $10,988.66 and in this connection urges the Court to adopt the following Finding of Fact:

"On February 17, 1960, Levi Swingle, acting as an officer of plaintiff, but without the knowledge or authorization of plaintiff's board of directors, executed an agreement between Groendyke Transport, Inc., G. E. Reagin, Leonard Cochran and plaintiff. (Plaintiff's Exhibit 30, Exhibit to petition and verified answer) Under that agreement, plaintiff was obligated to receive the proceeds of sales of oil by Reagin and to pay a portion thereof to Groendyke Transport, Inc., in satisfaction of

debts owed by Reagin to Groendyke. On various occassions between February, 1960, and October, 1964, oil sale proceeds were received by plaintiff of which portions were required to be paid to Groendyke under agreement. (Plaintiff Exhibit 30, Pretrial Order) Swingle misapplied such funds and caused them to be disbursed in breach of the agreement. Had Swingle properly paid the funds to Groendyke, the amount would have been more than sufficient to pay in full Reagin's indebtedness to Groendyke. (Plaintiff's Exhibit 30, Pretrial Order) Swingle concealed from other directors of plaintiff the fact that he had executed the said agreement and disbursed for purposes other than permitted by the agreement, rendering plaintiff liable to Groendyke. On February 16, 1965, Groendyke Transport, Inc., instituted a suit in the District Court of Payne County, Oklahoma, to recover damages from plaintiff on account of the disbursements of funds in breach of the said agreement. (Plaintiff's Exhibit 30) Plaintiff's directors employed counsel and defended the suit on the grounds, inter alia, that Swingle's actions had been without the approval or authorization of the directors. Prior to trial, however, on advice of counsel, plaintiff settled the suit by paying to Groendyke the sum of $10,988.66 on November 12, 1965, which sum was not recovered, resulting in a loss to plaintiff in that amount. (Plaintiff's Exhibit 30, 31, R 175, 177)"

The Court has carefully considered the claims of the plaintiff and finds and concludes that the proof in connection with this item falls short of the proof that is necessary for the Court to enter judgment on this item for the plaintiff; and, therefore, plaintiff's claim growing out of the Groendyke Reagin bank contract is denied.

6. During the period 1980 through 1984, plaintiff used a system of bookkeeping referred to as "deferred posting." All checks and deposits received on a business day were held overnight for posting to the ledgers of the individual customers' accounts on the following business day. (R 304-5, 491) At the close of business each day, a total of all checks drawn upon customers' accounts and received by plaintiff that day was computed. Similarly, all deposits to customers' accounts received by plaintiff that day were totaled. The net difference between the two totals was entered upon the plaintiff's general ledger and daily statement for such day in an account called "Individual Deposits Deferred." (R 133-4) The following day, as the various items were posted to the individual customers' ledgers, the bookkeepers would segregate all checks which could not be posted regularly due to insufficient funds, irregular signatures, post dating or other irregularity. The bookkeepers had no authority or discretion to post irregular checks. (R 78-82, 137-8) The irregular checks segregated by the bookkeepers were called "turnbacks", a term used in the

plaintiff bank, but apparently not commonly used in other banks. (R 266, 293, 303, 491-8)

7. The irregular or "turnback" checks were totaled and logged in the "turnback books" each day, showing the name of the customer on whose account the check was drawn and the amount of the check, or a total of all checks drawn on the account if there were more than two or three on a particular day. (R 87, 112, Plaintiff's Exhibit 4-10) The turnback books were regularly kept in the bookkeeping department, (R 116, 491-8) but prior to October, 1964, the books had never been seen by the national bank examiners or by any directors of plaintiff who were not also salaried employees. (R 146, 412, 695, 724, 730, 742, 773) Such a record or log is not customarily maintained by other banks. (R 293, 724)

8. All of the irregular or "turnback" checks were taken to the officers of plaintiff for review and determination of the disposition to be made of each. (R 137-8) The officers were only authorized to (1) approve checks for payment and posting as overdrafts to the customer's account, (2) hold checks temporarily as cash items on the books of the bank; or (3) refuse payment on checks and return them to their sources. (R 572-3, 749-50) Checks which were not returned to their sources by the business day following the day of receipt could not thereafter be returned and were purchased by the bank. (R 166, 272, 703)

9. From a time prior to June, 1962, Levi Swingle caused checks drawn by certain customers, when the deposits in their accounts were insufficient to pay such checks, to be held and paid from the funds of plaintiff without recording such checks as cash items or posting them to the customers' accounts as overdrafts. This practice was unknown to the directors of plaintiff, other than E. L. Roberts, and was not authorized or approved by them. (R 93, 412, 465, 477, 654-5, 108-9, 324, 395, 655-6, 688, 695, 781, 790, 792-3) In order to hold checks in this manner and to conceal the fact that they were so held, Swingle would, when the "turnback" checks were presented to him for review and disposition, withdraw all those checks that he wanted to hold and direct the bookkeeper to include such checks with checks received from other sources on that day and to process such checks again as if they had just been received. The checks so held were caused to be recycled day after day in the same manner. (R 78-82, 84-92, Plaintiff's Exhibit 29) Whenever in these findings reference is made to "cycling" or "holding and cycling" checks, such reference shall refer to the foregoing practice.

10. From a time prior to June, 1962, continuously until October 13, 1964, Levi Swingle caused checks and drafts drawn upon plaintiff by or for the account of George Earl Reagin doing business as Reagin Trucking

Company, when the funds on deposit in the account upon which such checks and drafts were drawn were insufficient to pay them, to be held by plaintiff and recycled in the manner described above. (R 77, 108) As a result, the checks and drafts so held could not be returned to their sources and were paid for and purchased with the funds of plaintiff. These checks and drafts were not recorded as cash items on plaintiff's records, nor were they posted as overdrafts to the Reagin account; rather, they were carried from day to day as a part of the deferred deposit account entry for the current day's business. (R 79, 133, 166, 272) Thereby, the books and records of plaintiff were dishonestly and fraudulently caused to falsely reflect the status of the Reagin account. (R 80, 273) E. L. Roberts knew, at the time, of Swingle's activities, but failed to advise or inform any other director of plaintiff. (R 395, 688, 781, 790, 792-3) In order to conceal further the fact that checks had been paid with plaintiff's funds and held within the bank, and as a part of his dishonest and fraudulent scheme, Swingle on various occasions caused transactions to be reflected on plaintiff's books and records as loans and purchases and on other occasions placed drafts known by him to be worthless in the channels of collection. (Plaintiff's Exhibit 31, R 153, 162) Swingle also placed loans for Reagin with other banks and personally made large undisclosed loans (Swingle Exhibit EE — JJ, R 624, 653-4)

11. In connection with the following claimed loss of $53,000.00, the plaintiff states as follows:

"On June 25, 1982, Reagin's known indebtedness to plaintiff was approximately $74,000.00. (Defendant's Exhibit 20) His worthless checks then being cycled by Swingle totaled $49,882.78. (R 183, Plaintiff's Exhibit 4D) On that date, there was deposited to the Reagin Trucking Company account $37,500.00 from the proceeds of loans from Stillwater National Bank. (R 151, 539) All such funds were used to redeem checks then being cycled and Swingle renewed the $74,000.00 loan without reduction. (R 150, Defendant's Exhibit 20) That loan was only partially paid and ultimately resulted in a loss to plaintiff of $53,000.00. (Defendant's Exhibit 20, Plaintiff's Exhibit 31) On the date of these transactions, had Swingle not then been dishonestly and fraudulently holding worthless checks in the cycle, the funds deposited to Reagin's account could have been applied to Reagin's note indebtedness to prevent the loss sustained by plaintiff (R 539-43)"

The Court finds and holds that the facts as stated by the plaintiff are not sufficient for the Court to allow the claim for the reason that the Stillwater National Bank made the loan, and the money coming from the Stillwater bank was that bank's money and cannot be classified as a plaintiff loss.

12. By November 26, 1962, Swingle had an accumulation in the cycle of checks drawn by Reagin totaling $160,065.48 which had been paid with the funds of plaintiff. (Plaintiff's Exhibit 4E) On that date, Swingle caused two loans in the amount of $80,000.00 each to be deposited to Edward Small and John E. Jones, and by their checks the proceeds of which were deposited to the Reagin account and factually cleared the cycled checks. (Defendant's Exhibit 39, R 152, 184, 617, 514-6) The two loans were not made with any expectation on the part of Swingle that they would be repaid by the purported borrowers; rather, they were for the purpose of concealing the truth and fact that the checks had been so cycled. (R 617) Swingle induced Robert W. Adams and Alma M. Blank to join with him in purchasing the Edward Small note from plaintiff to prevent its being classified as an excessive loan for which the directors might be personally liable. (R 356-362, 412-4) Nothing was ever received by plaintiff upon the John E. Jones note, resulting in a loss of $80,000.00 to plaintiff. (Plaintiff's Exhibit 31, R 375-6, 169-170) The Court finds that this is truly a fraudulent loss and it is the type of a loss upon which the plaintiff is entitled to interest from November 26, 1962, until paid.

13. On August 28, 1963, the checks of Reagin held by Swingle in the cycle totaled $112,604.35. (Plaintiff's

Exhibit 4G) On or about that day, Swingle caused the records of plaintiff to reflect that equipment had been purchased by plaintiff from Warren Transportation Company, which was operated by G. E. Reagin and his son Warren Reagin, and leased to Reagin Trucking Company. The $90,000.00 purportedly paid for the equipment was deposited into the Reagin account, along with other deposits, and the total of the checks in the cycle was reduced to $3,524.90. (Defendant's Exhibit 38, Plaintiff's Exhibit 4 G, R 152, 519-20, 548-50) Only $18,361.28 in depreciation, or principal, payments were recorded upon the lease account, resulting in a loss to plaintiff of $71,638.72. (R 178-9). This loss of $71,638.72 is truly a fraudulent loss. Interest from date of the loss is denied for the reason the exact dollar loss could not be clearly ascertained on August 28, 1963.

14. Swingle was holding in the cycle $210,592.85 of Reagin checks on June 20, 1964. (Plaintiff's Exhibit 4 I, R 162) On or about that date Swingle fraudulently substituted for most of those checks a draft in the approximate amount of $201,000.00, which he knew to be worthless and which he knew would be dishonored and returned when presented for payment to the bank upon which it was drawn. By substituting that draft and placing it in the channels for collection, Swingle was able

to temporarily remove the cycled checks from the bank. (Plaintiff's Exhibit 4 I, R 162-3)[1]

15. On October 9, 1964, a bank examination was in progress at the Farmers National Bank, the only other bank in Cushing. (R 267, 694) It was customary at that time that examinations of the plaintiff bank would commence on Monday morning. (R 267) On that date, Swingle was holding in the cycle Reagin checks totaling $295,656.51. (Plaintiff's Exhibit 4 I) In order to remove those checks from the bank and conceal the fact that they had been held and cycled, Swingle procured a draft in the amount of $295,656.51 drawn by G. E. Reagin on the New Mexico Bank and Trust Company of Eunice, New Mexico, which draft Swingle knew to be worthless. He substituted that draft for the accumulated checks and, on October 9, 1964, sent the draft from the bank in a cash letter to Commerce Trust Company, Kansas City, Missouri. The draft was subsequently returned to plain-

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[1]It appears the following suggested finding was out of place:

"On June 22, 1964, Swingle testified as a witness before the Referree in Bankruptcy in the Matter of Reaves Drilling Co., Inc., Bankrupt, and in his testimony admitted that he had engaged in the practice of holding and cycling of checks for Reaves Drilling Co., Inc. (R 218) On June 23, 1964, the regularly-scheduled monthly meeting of plaintiff's directors was held. (Plaintiff's Exhibit 5) In due course, the worthless draft was returned unpaid and the checks were again placed in the cycle on July 17, 1964. (Plaintiff's Exhibit 4 I) The use of the draft was an action by Swingle to conceal his dishonest and fraudulent activities at a time when he had reason to fear an inquiry might be made."

tiff unpaid. (R 167-8, 267-8, 284, 301) Thereafter, on or about October 20, 1964, transactions were recorded on plaintiff's books which purported to reimburse plaintiff for the draft and the cycled checks which it had replaced. These included the purchase of trucks and equipment for lease back to Reagin for the sum of $225,000.00, a loan to Reagin of $30,000.00, a loan to Warren Transportation Company, of which $31,000.00 was deposited to the Reagin account, a check for $7,000.00 deposited by Reagin, which was returned uncollected, and loans made on the supposed security of invoices to Kent Distributors Co. Neither the lease payments nor any of the loans was collected and plaintiff sustained a loss of $295,656.51 (R 153, 387). This is clearly a fraudulent loss. The date and amount of the loss are clearly established by the evidence, and the plaintiff is entitled to interest from October 9, 1964, until paid.

16. October 13, 1964 was the date of the regular monthly meeting of the board of directors of plaintiff. (Plaintiff's Exhibit 5) During the morning prior to the meeting, Swingle told E. L. Roberts that he intended to tell Robert W. Adams that checks of Reagin had been held and paid when Reagin had no funds on deposit. Roberts replied that Swingle should tell Adams, if he had not previously done so. (R 326, 795) That same morning, Swingle told Arthur Blaine Imel for the first time that

checks had been paid and held for Reagin. (R 655-6) Swingle stated that he intended to tell Adams, but none of the other directors. (R 698) When Adams arrived at the bank, Swingle told him that the checks had been held. (R 326) During the directors' meeting, Swingle, at the direction of Adams, told the directors that he had paid and held approximately $295,000.00 of checks for Reagin. (R 699, 796) He never previously told the directors that checks were being cycled. (R 656) He attempted to convince them, however, that the money could be recovered from Reagin. (R 386) None of the directors, other than Roberts, had known, prior to Swingle's disclosure, that Swingle or anyone in the bank was engaging in a practice of paying, holding and cycling checks of customers who didn't have money on deposit to pay their checks. (R 324, 395, 656) Because of the dishonest and fraudulent activities of Swingle, with the assistance and failure to disclose of Roberts, that practice and the true condition of accounts had been concealed from the directors. That concealment, together with Swingle's long association with the bank and the confidence placed in his ability and integrity, prevented the directors from being suspicious of any wrongdoing or dishonesty.

17. After the disclosures were made by Swingle on October 13, 1964, Adams sought the advice of a friend, who was a banker in Tulsa. That friend introduced Adams to Frank E. Brown, a senior national bank examiner.

(R 386-7, 264) Adams told Brown of Swingle's disclosure and Brown, with his examining crew, immediately [and on Oct 13/64 (handwritten insertion)] went to Cushing and commenced an examination of plaintiff bank. (R 265) That examination revealed the nature and extent of Swingle's dishonest and fraudulent activities in paying, cycling and concealing checks and the losses sustained and to be sustained by plaintiff. (Plaintiff's Exhibit 5, page 309, Defendant's Exhibit 8, R 421) During the course of that examination, the turnback books were first seen and reviewed by bank examiners and shown by them to the directors, who had not seen them previously. (R 266)

18. In addition to the losses sustained by plaintiff as the direct result of Swingle's dishonest and fraudulent acts in holding, paying and cycling checks, plaintiff incurred other substantial losses in transactions with Reagin and his affiliates. At times when he knew the true financial condition of Reagin and the extent of Reagin's indebtedness to plaintiff upon the cycled checks and recorded loans, Swingle caused additional funds of plaintiff to be advanced. Because of Swingle's dishonest and fraudulent concealment of the status of Reagin's indebtedness to the bank and his financial condition, plaintiff's directors were prevented from exercising knowledgeable supervision and control over Reagin's account and from taking appropriate action to minimize plaintiff's

potential losses by refusing further loans and attempting to collect existing indebtednesses. (R 400) Loans so made by Swingle and the resulting losses to plaintiff were:

Warren Transportation Company:	
Note 7173 dated October 20, 1964 —	$24,000.00
Note 1384 dated May 7, 1963 —	29,000.00
Note 1382 dated May 7, 1963 —	5,400.00
Warren A. Reagin:	
Note 1380 dated May 7, 1963 —	484.24
Note 2291 dated August 6, 1963 —	1,100.00
Note 5859 dated June 23, 1964 —	1,585.00
Total	$61,569.24

(R 153-4 Plaintiff's Exhibit 31)

The item of $61,569.24 is truly a fraudulent, dishonest loss to the plaintiff, but is such a mathematical problem that plaintiff is not entitled to interest from date of loss but from date of judgment.

19. Plaintiff subsequently attempted to reduce its losses by resorting the collateral securities and property acquired from Reagin which was in very poor condition and mostly inoperative. (R 327) Plaintiff realized net recoveries of $5,750.00. No evidence was presented to show that plaintiff could or should have realized a greater amount. This amount will be deducted from the losses found.

20. (a) The Court finds that from the early part of 1963, to May 6, 1964, a total of checks drawn by the Reaves Corporation and Reaves, a proprietorship, held and cycled by Swingle totaled $56,823.36 (Plaintiff's Exhibit 4 H, under date of May 6, 1964, R 236-8, 256-260). On May 8, 1964, Swingle purportedly made loans of plaintiff's funds of $56,800.00 against the proceeds of which the above mentioned cycled checks theretofore accumulated were charged on plaintiff's records. (R 160-2, 233, Plaintiff's Exhibits 34, 35, Bkptcy Trans. 33) The purported loans amounting to $56,800.00 were recorded as advances of $21,800.00 to the corporation (Plaintiff's Exhibit 35) and of $35,000.00 to the proprietorship (Plaintiff's Exhibit 34) These purported loans are represented by two unsigned notes — the signatures are shown as typed on each. The note envelopes (Plaintiff's Exhibits 34 and 35) contain respectively $85,000.00 notes signed December 31, 1963, upon which no funds were then paid or advanced by the bank. The notes evidencing the advances of $35,000.00 and $21,800.00 (Exhibits 34 and 35) each contain the statement: "This note is executed, delivered and accepted, not in payment, but for the purpose of extending the time for payment of a certain note dated December 31, 1963, No. _____, for $85,000.00." This statement was false, and was known to Swingle and Roberts to be false, for the reason that the due dates on these notes were the same as the two

$85,000.00 notes, and were not extensions as no funds had been advanced on the $85,000.00 notes, and there was no such existing loans to extend. As stated above the advances of $35,000.00 and $21,800.00 were mere subterfuges in order to clear the cycled, bad checks of Reaves. This method of handling these accounts by Swingle resulted in a loss to the bank of $56,800.00 (Plaintiff's Exhibit 31, R 217-8, Bktcy Trans. 30-33) The bank directors, other than Swingle and Roberts, were not aware of these transactions, which were concealed from them by Swingle and Roberts.

On April 10, 1964, Reaves Drilling Co., Inc. was adjudged bankrupt in the United States District Court for the Western District of Oklahoma. (R 160).

In accordance with the Court's Finding No. 20 (a) covering the $56,800.00 loss the Court holds and finds that such loss is and was the result of fraudulent, dishonest and wrongful acts and misappropriation of plaintiff's funds. The exact amount of this loss was not truly determinable until May 8, 1964, and plaintiff is entitled to judgment for the sum of $56,800.00, with interest from May 8, 1964.

(b) Plaintiff urges that the following Reaves losses are fraudulent and are recoverable, and in this connection plaintiff claims the evidence shows as follows:

"H. J. Reaves, an oil well drilling contractor, had

been a customer of plaintiff for many years. (Plaintiff's Exhibit 4) He maintained two accounts and lines of credit with plaintiff, one as 'H. J. Reaves d b a Reaves Drilling Company,' a proprietorship, and one as 'Reaves Drilling Co., Inc.,' a corporation he owned and controlled (Plaintiff's Exhibit 32, 33, 34, 35, R 222, 226) Beginning at least as early as 1960, Swingle, without the knowledge or authorization of plaintiff's directors, had engaged in the practice of paying, holding and cycling checks drawn by Reaves until funds were available in Reaves' accounts to pay them. (Plaintiff's Exhibit 4 R 324) In December, 1963, Reaves was hospitalized, suffering from terminal illness from which he died on January 8, 1964. (R 223, 455) On December 31, 1963, Reaves' proprietorship and his corporation were indebted to plaintiff in the total amount of $65,000.00. (R 155, 437) The indebtedness of the corporation was secured in part by the assignment of an invoice to Champlin Oil and Refining Company and in part by a mortgage on trucks and automotive equipment. (R 155-6, 229, 232, 251, Plaintiff's Exhibit 32, 33)"

(c) "On December 31, 1963, Swingle obtained the execution by H. J. Reaves, who was then hospitalized, of a promissory note payable to plaintiff in the amount of $85,000.00, made in the name of the proprietorship. (Plaintiff's Exhibit 34) On the same date, Swingle obtained the execution of a second promissory note in the

amount of $85,000.00 payable to plaintiff, made in the name of the corporation by O. M. Reaves, vice-president, and Hazel Moffatt, secretary. (Plaintiff's Exhibit 35) The maximum amount that plaintiff could loan to one customer was then $85,000.00. (R 235) No funds were then advanced upon either note. (Plaintiff's Exhibit 34, 35, R 235) Swingle did not record the notes in the bank's records or disclose their existence to the other directors. (R 259, 156) Plaintiff had no assignments of contracts or other rights to receive any funds out of payments due upon completion of the wells being drilled by Reaves. (Bkptcy. Tscpt. 39, 44, 68-70, 79) Other of the directors knew that he intended to finance completion of the drilling by Reaves' companies of certain oil wells in progress at the time of Reaves' death. (R 469-70) The directors who were aware of that intention were under the erroneous belief that plaintiff held assignments of the contracts for drilling such wells and would receive repayment when drilling was completed. (R 381) It was not known to any directors, other than Roberts, however, that Swingle intended to or did pay, hold and cycle checks of Reaves' companies. (R 77, 108-9, 324, 470-1, 476-7) Such checks were not recorded as overdrafts or otherwise in the ledgers of the accounts upon which they were drawn. (R 259)"

(d) "Continental-Emsco Company had accounts receivable owed by Reaves Drilling Co., Inc., which were

secured by materialmen's liens upon wells being drilled by Reaves. (Bkptcy. Tscpt. 71-2) In February, 1964, Continental-Emsco threatened to foreclose its liens and stop the drilling operations in progress. Swingle purchased those claims and lien rights, paying therefor $73,883.94 of the funds of plaintiff on February 11, 1964. (R 159, 234) D. A. Griffin, if not other directors, was aware of the purchase of the claims. (R 460, 465, 473) Adams was not aware of the purchase. (R 328, 382) Because of the concealment of Swingle and Roberts, however, neither Griffin nor any other directors were aware that, at the time of the purchase, Swingle was holding in the cycle Reaves' checks in the amount of $28,671.63 (Plaintiff's Exhibit 4H, R 159, 325, 465, 477) or that plaintiff did not have collateral assignments of the Reaves drilling contracts. (R 251, 328, 476) Plaintiff was unable to collect all of the claims, and, as a result of the misapplication of plaintiff's funds to purchase the claims, plaintiff sustained a loss in the amount of $55,767.74. (Plaintiff's Exhibit 31)"

(e) "Continental-Emsco Company held prior liens upon certain drill rigs and equipment upon which plaintiff also had liens. Continental-Emsco gave notice of foreclosure sale to be held on May 5, 1964. Swingle suggested that plaintiff purchase the rigs and equipment at that sale and resell them in an attempt to recover some of its losses. (R 254-5, 325, 456-8) D. A. Griffin con-

curred in that decision and the purchase was made. (R 382, 508-9, 456, 472) Upon resale of the rigs and equipment, plaintiff sustained a net loss of $16,327.77 plus an additional loss of $4,200.00 when payment in that amount had to be made to Gail Towne, who held liens upon some of the equipment sold. (R 164, 382-3, 459, Plaintiff's Exhibit 31)"

(f) "Swingle testified on June 22, 1964, in proceedings before the Referee in Bankruptcy in the matter of the Bankruptcy of Reaves Drilling Co., Inc. (Judicially Noticed—R 163) In that testimony, Swingle disclosed that he had obtained and held two $85,000.00 notes, had paid and held checks of Reaves totaling $56,800.00, had purchased the materialmen's liens from Continental-Emsco Company and that he had otherwise controlled the receipt and disbursement of funds of the Reaves companies after the death of H. J. Reaves and the adjudication of bankruptcy of the corporation. (R 221 et seq., Bkptcy. Tscpt.) As the result of Swingle's action, the Trustee in Bankruptcy sought to recover approximately $150,000.00 from plaintiff. Upon the advice of its attorney in the matter, plaintiff entered into a settlement of the Trustee's claims for the sum of $20,000.00. (R 426, Plaintiff's Exhibit 31) Upon payment of that amount on July 15, 1965, plaintiff sustained an additional loss of $20,000.00 as the result of Swingle's dishonest and fraudulent acts. (R 163) Plaintiff did not give notice to defend-

ant of its intention to affect the compromise and settlement prior to the consummation thereof and payment to the Trustee. (R 426) There is, however, no evidence of any prejudice resulting to defendant from plaintiff's failure to give prior notice of the settlement or from plaintiff's consummation of the settlement."

21. The Court concludes and holds that the claimed Reaves' losses as set out above in paragraphs 20 (b), (c), (d), (e) and (f) are not in truth and in fact fraudulent losses but are losses resulting from poor and bad judgment and are, therefore, not covered by the defendant's bond.

22. Plaintiff claims substantial losses growing out of the Jim Caton, Allied and family accounts and in this connection claims as follows:

(a) "For many years Jim Caton had been a customer of plaintiff. His account was handled by Swingle. (R 316) Caton, through Caton, Inc., a corporation owned and controlled by him, engaged in the oilfield trucking and dirt moving business, operating bulldozers, trucks and related equipment. (R 460) Commencing about 1963, Swingle wrongfully engaged in a series of activities by which funds of plaintiff were loaned to Caton in amounts in excess of the maximum amounts that plaintiff could legally loan to a single borrower and in excess of the amounts which would have been loaned to Caton under sound and reasonable banking standards. (R 170-4)"

(b) "To conceal the full amount of the loans made to Caton, Swingle dishonestly caused portions of such advances to be recorded as apparently independent loans to other borrowers, including Valton Wood, W. M. Smith, Harvey Crow, Bob L. Crow, Starlan Crumbell and Calvin Matherly. (Plaintiff's Exhibit 24-28) All of the proceeds of loans in such names were deposited to Caton's account or used to discharge prior Caton loans. (R 51, 170-4) All of the ostensible borrowers in whose names loans were recorded by Swingle were employees of Caton, and additionally, Valton Wood and Harvey Crow were brothers-in-law of Caton. (Plaintiff's Exhibit 28) To conceal further the true nature and purpose of the loans made to and for the benefit of Caton, Swingle caused the records of plaintiff to reflect purported collateral securities and endorsements of such loans, knowing that the collateral securities and endorsements were duplicated on other existing loans and that they were not of sufficient value to protect plaintiff against losses on such loans. (Plaintiff's Exhibit 24-28, 170-4, 197-9)"

(c) "Because of the concealment by Swingle of the nature, purpose and extent of the loans made to and for the benefit of Caton, the directors of plaintiff were prevented from exercising informed or knowledgeable supervision of Caton's line of credit with the bank and from acting to prevent or reduce the losses which the bank

sustained on such loan. (R 384) When the previously concealed facts regarding the Caton transactions were discovered, plaintiff made diligent efforts to collect such loans to obtain at least partial repayments. Notwithstanding such efforts, plaintiff sustained losses totaling $151,681.22 as the result of Swingle's dishonest activities in misapplying the funds of plaintiff for the benefit of Caton."

(d) "In May, 1985, Jim Caton, through his attorney, threatened that, unless plaintiff accepted the terms of a proposed settlement arrangement with Caton, Caton and his corporation would seek relief through bankruptcy proceedings. Since a declaration of bankruptcy would have increased plaintiff's potential losses, on May 28, 1985, an agreement was entered into whereby plaintiff released Caton from further liability to plaintiff on the previous loans. (R 69, R 493, Defendant's Exhibit 19) Plaintiff did not give defendant prior notice of the execution of the release of Caton. None of the other purported borrowers were released and there is no evidence of any prejudice resulting to defendant from plaintiff's failure to give prior notice of the settlement or from plaintiff's consummation of the settlement."

23. The Court holds and finds that after Swingle had retired as an officer and director of the bank, the new officers executed and delivered a full and complete

release of the Jim Caton and Allied account losses as set out in paragraph 22 (a), (b), (c) and (d) and without the knowledge or acquiescence of the defendant Surety Company, and these losses are not truly fraudulent losses and are not covered by the defendant's bond; therefore, the claimed losses are denied.

24. All of the losses sustained by plaintiff, as set forth herein, were discovered while both the Bankers Blanket Bond and the Excess Fidelity Policy were in force and effect.

25. Promptly upon discovery that it had sustained losses which were within the coverage of the bond and policy, plaintiff gave notice thereof to defendant by telephone and in writing. (R 40, 420, Plaintiff's Exhibit 2) Upon receipt of such notice, defendant through its agents and attorneys, conducted its own investigation of plaintiff's losses and the surrounding circumstances. (R 41, Plaintiff's Exhibit 3) Defendant was not prejudiced or damaged in any manner by the failure of plaintiff to give any prior or additional notice of the losses which it sustained.

26. The evidence clearly shows that plaintiff incurred expenses in preparing valid claims under the bond before the Court, and the plaintiff is entitled to recover for such expense the sum of $1,000.00 which is allowed.

27. The losses sustained by plaintiff and described

herein was not attributable, in whole or in part, to economic conditions in the area of Payne County, Oklahoma, or in the oil, trucking or drilling industries. (R 431-3)

38. As directors of plaintiff, Robert W. Adams, Alma M. Blank, Arthur Blaine Imel, James E. Berry, D. A. Griffin and George M. Berry at all times acted in good faith as honest, reasonable, diligent, trustworthy and conscientious directors. Each of them was, in all respects, free from negligence. These said directors each took an active interest in the affairs of the bank, held and attended meetings regularly, (Plaintiff's Exhibit 5) appointed committees in accordance with the bylaws of plaintiff, (Plaintiff's Exhibit 5) which committees, insofar as these directors were concerned, acted diligently and honestly, (R 115, 371) and these directors exercised the necessary degree of care and prudence in respect to all their duties. (R 450, 453, 648, 682, 691-5)

39. Levi Swingle and E. L. Roberts were the managing officers of plaintiff and as such had a duty to be honest and truthful and to disclose all information, good and bad, to the other directors of plaintiff. Swingle and Roberts did not disclose to, but concealed from, the other directors of plaintiff the fact that checks were being paid, held and cycled and other facts which would have revealed the true nature and circumstances of transactions between plaintiff, Reagin and Reaves as set

forth above. Also, Swingle and Roberts fraudulently concealed from the bank examiners the true facts relating to cycling and payment of checks.

30. Robert W. Adams, Alma M. Blank, James E. Berry, D. A. Griffin, George M. Berry and Arthur Blaine Imel did not know of Swingle's activities in kiting, paying and cycling checks as described above, and, did not and could not, with the exercise of that degree of due care and diligence required of national bank directors, discover such acts and practices.

31. Plaintiff was examined by national bank examiners on April 3, 1981, November 27, 1981, July 24, 1982, February 12, 1983, and October 21, 1983. (Defendant's Exhibit 3-7) A written report of each examination was prepared by the examiner, but a copy was not delivered to plaintiff until several weeks after the examination. (R 701) Ordinarily, during the course of the examination the senior member of the examining crew would meet with the managing officers of the bank, and sometimes with one or more of the non-officer directors, for the purpose of reviewing the bank's loan accounts and discussing any other matters which the examiner considered to be of importance. (R 341, 343, 702) In each of the reports of these examinations the lines of credit of Reagin, Reaves and Caton were commented upon by the examiner and the strength of the security and record of repayment was criticized. The Reagin line of credit

was discussed in 1981 at a meeting in Kansas City, Missouri, attended by Swingle, Adams and the district chief national bank examiner. (R 345)

32. The reports of bank examinations were always reviewed by plaintiff's directors when the reports were received. (R 482-3) All criticized loans were considered and discussed carefully, and the managing officers were required to explain the circumstances surrounding them. (R 348) Swingle, in whose ability and integrity the directors placed full confidence, on all occasions explained satisfactorily the status of all criticized loans and borrowers and the efforts being made to reduce and recover the outstanding loans. (R 329, 351, 389, 491)

33. After the bank examination of November 27, 1981, the examiner reported cash items totaling $8,121.64 and commented that items not posted or returned should be carried as cash items, rather than bookkeeper returns. (Defendant's Exhibit 4, page 10) That report was received and reviewed by the directors on February 13, 1982. (Plaintiff's Exhibit 5, page 283) At that time the items commented upon had been cleared from the bank and an explanation of the circumstances was given by Swingle. (R 35) The report of the examination of July 24, 1982, listed cash items totaling $13,638.17 and contained the comment: "Is bank's overdraft policy subject to criticism? No; however, the holding of bookkeeper's returns to prevent overdrafts is objected to." (Defend-

ant's Exhibit 8, page 10) In commenting upon the Seagin line of credit, the examiner noted that checks drawn by Seagin had been held as cash items when expected proceeds from outside financing had failed to materialize. Three items were cleared prior to the examination, however, and the report states that the line was not excessive on the date of the examination. (Defendant's Exhibit 8, page 8A) These comments were reviewed by the plaintiff's directors on October 9, 1962, (Plaintiff's Exhibit 5, page 227) and explained by Swingle and Roberts. (R 339, 352, 354, 355) In the report of the national bank examination of February 12, 1963, the examiner listed certain cash items and commented that most of them had been carried in bookkeeper returns. The examiner said that the bank's overdraft policy was not subject to criticism, but objected to the holding of bookkeepers' returns to prevent overdrafts. (Defendant's Exhibit 6, pages 2, 10) The national bank examiners' comments were considered when this report was reviewed by the directors on March 12, 1963. (Plaintiff's Exhibit 5, page 253) At that time; the items commented upon had been cleared and Swingle explained the circumstances to the directors. (R 371)

34. During the examination of plaintiff on October 21, 1963, a special effort was made by the examiners to determine whether there were any irregularities in the posting or handling of checks. (R 739) None were dis-

covered and the report of that examination contains no adverse comments upon the handling of checks. (R 287, 720) The bank examiners never discovered nor became aware of Swingle's practice of cycling large amounts of checks prior to October 13, 1964. Prior to that date, the examiners had never been aware of the existence of the turnback books. (R 734) No examiner had considered the known holding of bookkeepers' returns of sufficient consequence to warrant mentioning it in any conference with plaintiff's directors. (R 410-11, 705) The examiner who prepared the reports containing comments discussed above did not intend by such comments to inform or alert plaintiff's directors to the fact that Swingle was cycling checks within the bank and the examiner did not suspect or discover the existence of such a practice. (R 270, 723-5, 731-3)

35. The bond of defendant carries a $100.00 deductible provision, and credit for this amount must be deducted from the amount of the judgment.

Conclusions Of Law

1. The Court has jurisdiction of the parties and subject matter herein.

2. To render bank directors liable for losses resulting from fraudulent and wrongful acts of other officers, such directors must participate therein, or they must be chargeable with culpable negligence or negligent conduct in relation thereto.

3. A bank director is not an insurer and is not liable for losses that occur which were not the fault of such director.

4. It is the duty of bank directors to exercise ordinary care and prudence in the administration of a bank, and this requires more than officiating as a figurehead. They are entitled to commit the bank business to their duly authorized officers, they must maintain reasonable supervision, and they should not be permitted to be shielded from liability for loss which results from their gross inattention. But, where a director is honest and diligent in his duties and exercises ordinary care, then such director is not liable for losses resulting from the misconduct of executive officers of the bank.

5. The defendant and third-party plaintiff is not entitled to any relief or judgment as against any of the third-party defendants Robert W. Adams, Arthur Blaine Imel, Robert W. Adams as Executor of the Estate of Alma M. Blank, deceased, George M. Berry, D. A. Griffin or Frank C. Berry and George M. Berry as Executors of the Will of James E. Berry, deceased.

6. It is the duty of an officer of a bank to act at all times honestly, fairly and for the best interest of the bank and to inform and advise the bank examiners and the directors of the bank of all matters within his knowledge relating to the business of the bank, whether such matters be favorable or unfavorable to the bank.

7. It is the duty of an officer of a bank to cause the books and records of the bank to truly and correctly reflect the condition of the bank and the nature of all the bank's transactions and not to hide or "cover up" any material matter.

8. The payment, holding and cycling of checks and drafts, as described in the foregoing Findings of Fact, and the concealment thereof in the records of the plaintiff and from the directors of the plaintiff was dishonest and fraudulent.

9. The concealment from the directors of plaintiff by Levi Swingle and E. L. Roberts of the true nature, purpose and circumstances of transactions between plaintiff, G. E. Reagin, Reeves account and their affiliates, as described in the foregoing Finding of Fact, was fraudulent, dishonest and unlawful.

10. Plaintiff is entitled under the terms of the Bankers Blanket Bond and the Reeves Fidelity Policy to recover from defendant:

A. For the loss in the amount of $22,500.00 sustained by plaintiff as a result of the transactions on November 28, 1962, in which that amount was purportedly loaned to Dr. John E. Jones in order to clear cycled checks of Reagin, as described in Finding of Fact 12.

B. For the loss in the amount of $72,638.72 sustained by plaintiff as a result of the transactions on An-

gust 28, 1963, in which equipment was purportedly purchased from Warren Transportation Company and leased to Reagin Trucking Company in order to clear cycled checks of Reagin, as described in Finding of Fact 13.

C. For the loss in the amount of $289,806.51 sustained by plaintiff as a result of cycled checks of Reagin in that amount which Swingle was holding on October 13, 1964, when he disclosed his wrongdoing to the directors, as described in Finding of Fact 16.

D. For the losses totaling $61,569.24 sustained by plaintiff as a result of Swingle's dishonest and fraudulent concealment from plaintiff's directors of the true circumstances surrounding the Reagin accounts, as described in Finding of Fact 18.

E. The expenses incurred in the preparation of claims in the amount of $1,000.00 set forth in Finding of Fact 26.

F. For the loss in the amount of $56,800.00 sustained by plaintiff as a result of cycled bad checks of Reaves, as described in Finding of Fact 20(a).

11. Any person who is entitled to recover damages in an amount capable of being made certain by calculation, the right to recover which is vested on a particular day, is entitled also to recover interest thereon at the rate of six per cent (6%) per annum from that day and

to have the amount included in any judgment rendered for recovery of such damages.

12. The plaintiff would have been entitled to recover from Levi Swingle and E. L. Roberts, jointly or severally, the full amount of its losses caused by their dishonest and fraudulent activities and neglect of duty.

13. The defendant and third-party plaintiff will, upon payment to the plaintiff for the losses sustained by the plaintiff as the result of the dishonest and fraudulent activities and neglect of duty of Levi Swingle and E. L. Roberts, be subrogated to the rights of the plaintiff against those individuals and entitled to recover from them the full amount of its liability to the plaintiff, when paid.

14. The costs and disbursements in this action, except such costs and expenses as may have been incurred by third-party defendants Levi Swingle and E. L. Roberts, should, in fairness and justice be borne and paid by the defendant and third-party plaintiff.

15. The Court, therefore, finds and concludes the losses described in these Findings to be (a) $80,000.00, (b) $71,638.72, (c) $295,656.51 (less $5,750.00 Finding 19, and less $100.00, Finding 35) or a net total on item (c) of $289,806.51, (d) $61,568.24, (e) $1,000.00, (f) $56,800.00, making a total of $580,814.47. Interest should be allowed and recovered by plaintiff on the sum of $80,000.00 at six per cent (6%) per annum from July 1,

1964, until paid, on the sum of $289,806.51 from October 9, 1964, at six per cent (6%) per annum until paid, and on the sum of $56,800.00 from May 8, 1964, at six per cent (6%) per annum until paid, and on the sum of $134,207.96 from the date of judgment until paid.

Dated this 27 day of November, 1968.

Luther Bohanon
United States District Judge

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Filed November, 1968

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Judgment

Based upon the Findings of Fact and Conclusions of Law this day filed with the Clerk of this Court, it is

The Judgment Of This Court that the plaintiff, First National Bank of Cushing, Cushing, Oklahoma, a national banking corporation, have and recover of and from the defendant and third party plaintiff, Security Mutual Casualty Company, a corporation, the sum of $580,864.47; it is the further judgment of the Court that the plaintiff have and recover of and from the defendant interest at the rate of six per cent (6%) per annum as follows: on the sum of $80,000.00 from July 1, 1964, until paid, on the sum of $289,806.51 from October 9, 1964, until paid, and on the sum of $56,800.00 from May 8, 1964, until paid, and on the sum of $134,207.96 from the date of this judgment until paid.

It is the further judgment of this Court that the defendant Security Mutual Casualty Company, a corporation, have judgment against the third party defendants Levi Swingle and E. L. Roberts, for the full amount paid under this judgment by Security Mutual Casualty Company, a corporation, to the plaintiff.

The costs and disbursements in this action, except such costs and expenses as may have been incurred by third party defendants Levi Swingle and E. L. Roberts, are taxed against the defendant, Security Mutual Casualty Company, a corporation.

Dated this 27th day of November, 1968.

Luther Bohanon
United States District Judge

Filed November 27, 1968

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Corrected Judgment

As provided by Rule 60 Federal Rules of Civil Procedure, the judgment of the Court filed herein, dated November 27, 1968, is amended and corrected to read as follows:

Beginning at the fifth line of the second grammatical paragraph the following should be deleted:

"the sum of $580,884.47"

and inserted therein:

"the sum of $580,814.47"

Dated this 6th day of December, 1968.

Luther Bohanon.
United States District Judge

Filed December 6, 1968